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Supreme Court of the United States.

OCTOBER TERM, 1937.

No. 19.

BRADLEY W. PALMER,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

No. 59.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

BRADLEY W. PALMER.

BRIEF FOR BRADLEY W. PALMER.

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STATUTE CITED.

Revenue Act of 1928, §115a. 2

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BRIEF FOR BRADLEY W. PALMER.

These cross-writs of certiorari bring up a judgment of the Circuit Court of Appeals for the First Circuit reversing (under date of February 12, 1937) an order of the Board of Tax Appeals. The parties will be referred to as "the taxpayer" and "the Commissioner," respectively.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals is reported in 32 B.T.A. 550. The opinions of the majority and minority of the Circuit Court of Appeals appear in 88 F. (2d) at pages 559 and 562, respectively.

Questions Presented.

The taxpayer received as a stockholder of The American Superpower Corporation certificates entitling him to buy of that corporation at specified prices shares of stock in other corporations owned by it. The taxpayer availed himself of the opportunity afforded by the certificates and purchased the stock to which they related. The Board of Tax Appeals found as a fact (R. 163, 169) that the issue of the certificates and the purchase of stock by virtue of them was a bona fide sale and purchase and was not intended to constitute and did not constitute a dividend within the meaning of the governing statute (Revenue Act of 1928, §115a), which reads as follows:—

> "The term 'dividend' when used in this title . . . . means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913."

The Board further found as a fact that the fair market value of the stock in question did not exceed the amount paid by the petitioner for it (R. 164, 170-171).

Briefly stated the questions now presented are,—

(1) Whether (*a*), if it be assumed that the value of the stock in question at the decisive dates,—whatever those may be,—was in excess of the prices paid by the taxpayer, it was competent for the Circuit Court of Appeals to override the finding of the Board as to the nature of the transaction and to rule that the receipt of the certificates and the purchase of stock by virtue of them constituted a dividend, and whether (*b*) it was competent for the Circuit Court of Appeals to override the finding of the Board as to the fair market value of the stock and to hold that the value at the decisive dates was materially more than the prices paid by the taxpayer.

(2) Whether, if it be assumed that there was such an excess of value and that the transaction constituted a dividend, the excess is to be ascertained as of the date when the purchase certificates were received by the taxpayer or as of the date when the taxpayer exercised his option to purchase.

Statement.

The case was heard by the Board of Tax Appeals upon a long stipulation of facts (R. 64-155), much of which is now immaterial, either because it related to a minor issue as to which both parties accept the decision of the Board or because the subject-matter is covered by findings of the Board as to which no question is raised.

It was agreed that during the year 1929 the taxpayer was the owner of common stock of The American Superpower Corporation and that as such he received on three occasions during that year certificates authorizing him to buy of that corporation at specified prices shares of stock in other corporations owned by it (R. 65, 161-162). The first of these issues of purchase certificates was voted by the directors on January 23, 1929, and related to the purchase of shares of The United Corporation (R. 66). Starting on January 25, 1929, and continuing to February 18, 1929, when the "rights" expired, they were traded in on the New York Curb Exchange. In the highly speculative market then existing the "rights" ranged in price from 11⅝ to 21 in a space of five days (R. 67).

There was nothing to indicate that these substantial sale prices were foreseen by the parties at the time when the plan of issuing purchase certificates to the stockholders of The American Superpower Corporation was formed or that the plan was in any sense a cloak to cover a dividend. On the contrary, it appeared that the formation of The

United Corporation was the outgrowth of an agreement entered into in 1928, by J. P. Morgan & Company and other bankers (including Bonbright & Company, who controlled The American Superpower Corporation), whereby the parties agreed to act in unison with respect to their holdings of large blocks of stock in the Public Service Corporation of New Jersey, The United Gas Improvement Company and the Mohawk Hudson Power Corporation (R. 73-74). As a result of further negotiations it was agreed in December, 1928, to organize a holding company and transfer to it the stock in question in exchange for its own securities (R. 74-75). On January 7, 1929, The United Corporation was organized accordingly (R. 75). On January 9, 1929, the directors of The American Superpower Corporation accepted a proposition of The United Corporation to issue certain of its securities to The American Superpower Corporation in exchange for shares of Public Service Corporation of New Jersey and of The United Gas Improvement Company (R. 76; for complete copies of the proposition and of the minutes of the meeting at which action was taken thereon see R. 49-52 and R. 39-49, respectively). The minutes contain the following recital respecting a statement made by Alfred M. Loomis, president of The American Superpower Corporation, to the directors just before they voted to accept the proposition of The United Corporation (R. 47):—

> "Mr. Loomis stated that, if the offer were accepted and the stock of The United Corporation acquired, as therein contemplated, the officers expected at some later date to submit to the Board a proposition, by which The American Superpower Corporation would dispose of a substantial part of the stock of The United Corporation so acquired to the holders of the common stock of the American Superpower Corporation by offering to said stockholders a right to purchase part

of the Corporation's holding of The United Corporation stock. By this means, there would be a wide distribution of the stock of The United Corporation."

Even before the organization of The United Corporation the officers of The American Superpower Corporation had formed the intention of offering to the stockholders a substantial part of the stock of The United Corporation when received. The facts as to this matter were stipulated as follows (R. 79-80):—

"In connection with certain of the conferences which preceded the formation of The United Corporation, the matter of the disposition by The American Superpower Corporation of a part of the stock of The United Corporation to be received by it was discussed. Mr. Harold Stanley of the firm of J. P. Morgan and Company initiated such discussion. In that connection Mr. Alfred L. Loomis of Bonbright and Company (who was also chairman of The American Superpower Corporation) stated to some of the other parties to the negotiations, including Mr. Stanley, that at the first meeting of the board of directors of The American Superpower Corporation which would be called to consider the acquisition by The United Corporation of the common stock of the Public Service Corporation of New Jersey and the common stock of The United Gas Improvement Company held by The American Superpower Corporation he intended to advise the board that the officers of The American Superpower Corporation expected to submit to the board at some later date a proposition by which The American Superpower Corporation would dispose of a substantial part of the stock of The United Corporation to be so acquired."

The Commissioner of Internal Revenue in determining the federal tax liability of The American Superpower Corporation for the year 1929 found that the total fair market value of The United Corporation securities when received by The American Superpower Corporation was $72,480,000, which was substantially the aggregate market value of the securities given in exchange (R. 80-82, 84-85). For this purpose the Commissioner allocated a value of par to the preference stock, one dollar to each of the option warrants (entitling the holder to purchase common shares at $27.50 as above stated) and $25 per share to the common stock (R. 84-85, 164).

J. P. Morgan & Company and Bonbright & Company, pursuant to agreements with The United Corporation, each subscribed for and bought 400,000 shares of its common stock at $22.50 per share (R. 97-99, 164).

The American Superpower Corporation did not reflect on its books of account any profit or loss in connection with the exchange of securities previously held by it for securities of The United Corporation, though the securities so transferred had cost it only $25,945,093.88 (R. 83-84).

In accordance with the plan above described, the directors of The American Superpower Corporation on January 23, 1929, voted to offer to the common stockholders of record January 26, 1929, the privilege of purchasing at $25 per share one half of a share of the above-mentioned stock of The United Corporation for every share of common stock held in The American Superpower Corporation, this privilege to be evidenced by negotiable purchase certificates which should become void unless the privilege of purchase were exercised on or before February 15, 1929 (R. 15-16, 66).

On May 1, 1929, and June 5, 1929, respectively, the directors of The American Superpower Corporation voted to offer to the common shareholders the privilege of purchas-

ing additional stock of The United Corporation at $30 per share and stock of The Commonwealth & Southern Corporation (in the organization of which The American Superpower Corporation had participated in May, 1929) at $15 per share (R. 24-26, 31-33).

Pursuant to these votes the taxpayer received on February 1, 1929, May 5, 1929, and June 24, 1929, respectively, certificates giving him the privilege of purchasing 3198 shares of The United Corporation at $25 per share, 1599 shares of The United Corporation at $30 per share and 3200 shares of The Commonwealth & Southern Corporation at $15 per share (R. 66, 68, 71).

On February 15, 1929, the taxpayer exercised his option under the first set of purchase certificates and purchased the shares to which these referred, paying for such shares $79,950 (R. 67). On May 24, 1929, the taxpayer exercised his option under the second set of purchase certificates and purchased the shares to which these referred, paying for such shares $47,970 (R. 69). On July 2, 1929, the petitioner exercised his option under the third set of purchase certificates and purchased the shares to which these referred, paying for such shares $48,000 (R. 72). Each of these sales represented a considerable profit to The American Superpower Corporation over the cost of the property exchanged by it for stock of The United Corporation and of The Commonwealth & Southern Corporation, respectively (R. 85-86).

The taxpayer did not during the year 1929 sell or otherwise dispose of any of the stock purchased by him as aforesaid. Being advised that his receipt of the respective purchase certificates and the purchases made by him thereunder gave rise to no taxable income, he did not include in his return of income for 1929 any item reflecting these transactions. The Commissioner ruled to the contrary and assessed a deficiency with respect to the alleged market values of the purchase certificates as of the dates fixed by

the respective resolutions for determining the stockholders of record entitled to participate therein (R. 4, 11-12, 63).

The Board of Tax Appeals made the following findings as inferences from the facts summarized above and from the great mass of additional detail contained in the stipulation (R. 160, 164, 169; italics supplied):—

> "At the time of the organization of United, Superpower contemplated selling a portion of the United common shares to be acquired by it to its stockholders. *This was for the purpose of building up its cash position and of creating a wide market for the United stock.* As soon as it received United common stock it offered to sell pro rata to the holders of its class A and class B common stock a one-half share of United common stock for each of its common shares outstanding, at $25 per share.
>
> * * * * * * * * * *
>
> "As above indicated, the stipulated facts show that the respondent determined the 'total fair market value' of all the securities received by Superpower from United in January, 1929, to be $72,480,000. He allocated this value to the three classes of securities received and determined the fair market value of the common shares to be $25 per share. This is the exact price at which Superpower offered the first block of 821,472 shares of common stock of United to its stockholders. *No valid argument can be made that Superpower intended to distribute to its stockholders any portion of its assets by selling 821,472 common shares of United to them at a fair market value.* Upon the sale of the stock at $25 per share Superpower realized a profit of $16.05 on each share. That $25 was a fair market price for the stock in January 1929 is further evidenced by the fact that J. P. Morgan & Co. and Bonbright &

Co., pursuant to the agreement made between the interested parties, each subscribed for and purchased from United 400,000 shares of its common stock at $22.50 per share.

"The stipulated facts do not show the fair market value of United common stock in May 1929, or of Commonwealth common stock in June and July 1929. The sales of United common in May 1929 were made at $30 per share, or at $5 per share more than the price at which the stock was offered to Superpower's stockholders in January. The Commonwealth stock was acquired by Superpower just before it was offered for sale by Superpower to its stockholders. In selling it at $15 per share Superpower made a profit on each share sold.

* * * * * * * * *

"Upon the entire record we are of the opinion that the petitioner realized no taxable income from the receipt of the purchase certificates involved in this proceeding or from the exercise of them in the purchase of shares of stock of United and Commonwealth. *There is no reason to give to the transaction a different interpretation from that placed upon it by both Superpower and the petitioner. Superpower treated the transaction solely as a sale of a portion of its assets and accounted for the profit realized therefrom. The petitioner likewise treated the transaction as a purchase of shares of stock for cash. If and when he shall sell the shares acquired by him the profit or loss must be predicated upon the basis of the price that he paid for them.*"

The Commissioner petitioned the Circuit Court of Appeals for the First Circuit to review the decision of the Board. The majority of the court accepted the Board's

findings of fact except those relative to the fair market value of the stock purchased by the taxpayer by virtue of the certificates issued to him. As to this point the court assumed to set aside the Board's conclusions and to draw the inference,—chiefly from the market quotations for the purchase certificates,—that the stock to which the respective certificates related was worth substantially more on the dates when the certificates were received than the amounts paid by the taxpayer to The American Superpower Corporation (R. 190-191). The majority then went on to say (R. 191-192):—

> "Apparently the Board held that an intention to make a distribution was essential in order to make the transaction a dividend. The question is not one of intention but of what was in fact done.
>
> "The statute defines dividend. 'The term dividend when used in this title . . . means any distribution made by a corporation to its shareholders whether in money or in other property,' etc. Rev. Act of 1928, chap. 852, Sec. 115 (a). It says nothing about intention. The transaction is to be judged by the effect of it. Where the matter is doubtful the intention of the parties may well be accepted, especially when the property distributed has not a definitely ascertainable value which can be promptly realized. Here the property distributed was readily salable at about twice the amount paid for it. For practical purposes it was equivalent to money. We think the excess value of United stock above the price at which Superpower sold it was clearly a dividend."

The majority further said that "the rights themselves were [not] taxable income," but that, "if exercised, the excess of value of the property acquired over the cash paid for it was a distribution of property and was taxable at

its fair value'' (R. 192). On the strength of the market quotations which were in evidence the majority further held that, notwithstanding the findings of the Board as to the actual value of the stock referred to in the purchase certificates, it had a value substantially in excess of the amounts paid for it and that ''the excess value of . . . [the stock] above the price at which Superpower sold it was clearly a dividend,'' saying that the question was ''not one of intention, but of what was in fact done'' (R. 191-192). As to the dates with respect to which the value should be ascertained the majority said (R. 192):—

> ''The value of the shares of stock should be determined as of the dates when the stock rights were exercised, viz.: under the first offering as of February 15, 1929, under the second offering as of May 24, 1929, and under the third one as of July 2, 1929, for these are the dates on which the taxpayer, in this case, in fact received taxable distributions.''

In a dissenting opinion Judge Wilson said (R. 195-197):—

> ''This was not a distribution of corporate assets, but a sale at a price found by the Commissioner to represent the fair market value of the United stock. The cash received therefor by Superpower restored to it as assets the proportionate fair market value of the securities exchanged by Superpower for the stock of United.
>
> ''We are not concerned with what might have resulted if the petitioner had sold the purchase certificates, or had sold the stock acquired after the exercise of his right to purchase. He did neither.
>
> * * * * * * * * *
>
> ''There is no evidence that the offering of the stock of the United was intended by Superpower as a cloak

for what in fact was a dividend. The Board of Tax Appeals found as a fact that it was not. This court cannot review this finding.

* * * * * * * * *

"Obviously the taxpayer cannot be taxed as income based on the selling price of the purchase certificates during the period he held them, since he did not realize income from them. If he failed to exercise them, he could claim no loss. *Eastern Shares Corporation* v. *Commissioner,* 32 B.T.A. 608. To him they simply represented a right to buy United stock. When exercised they became merely an acceptance of an offer to sell. If the stock proved to have an increased market value in the boom market of 1929 over the cash paid the company, he has not realized on it. To determine taxable income there must be a sale or exchange of property, or something definite other than a fluctuating stock exchange market. The court does not recognize theoretical gains or losses."

In accordance with the opinion of the majority, the Circuit Court of Appeals on February 12, 1937, ordered that the decision of the Board of Tax Appeals be vacated and the case remanded to that Board for further proceedings not inconsistent with the opinion (R. 197). Upon the motion of the taxpayer it was subsequently ordered that the issue of the mandate be stayed (R. 197).

On May 17, 1937, this court granted the taxpayer's petition for a writ of certiorari to review the decision of the Circuit Court of Appeals in so far as it involved a ruling that the receipt of the purchase certificates and the purchase of stock by virtue of them constituted a dividend (R. 197).

On June 1, 1937, this court granted the Commissioner's petition for a writ of certiorari to review the same decision

in so far as it involved a ruling that, assuming that the transaction constituted a dividend, the value of the shares purchased should be determined as of the dates when the purchases were actually made and not as of the dates when the respective purchase certificates were received by the taxpayer (R. 198).

Specification of Errors.

The petitioner's objections to the decision of the Circuit Court of Appeals may be summarized as follows:—

1. The court erred in not accepting the finding of the Board of Tax Appeals as to the nature of the transactions in question and in assuming to find that these transactions constituted dividends and gave rise to tax liability as of the dates upon which the rights evidenced by the respective purchase certificates were exercised by the petitioner.

2. The court erred in not accepting the finding of the Board of Tax Appeals as to the value of the stock which the petitioner bought and in assuming to make different findings on that subject.

The error assigned by the Commissioner is in substance that the Circuit Court of Appeals should have held that the amount of the supposed dividends should be determined as of the dates when the respective purchase certificates were received, and not as of the respective dates upon which the taxpayer exercised his right to purchase the stock in question.

Summary of Argument.

1. The transactions in question gave rise to no taxable income.

(*a*) A sale of property by a corporation to its stockholders is not taxable as a dividend simply because the

price may have been less than the fair value of the property. If the real purpose is to pay a dividend and the form of a sale is adopted in order to conceal the true nature of the transaction, the substance will doubtless prevail over the form. If, correspondingly, the object is to obtain funds for the corporation through the sale of the property in question and there is no intention to pay a dividend, the transaction constitutes a sale even if the opportunity to buy is offered to the stockholders in proportion to their holdings. If the purpose is to effect a sale and not to pay a concealed dividend, the mere issue of purchase certificates like those now under consideration plainly gives rise to no tax, since the assets of the corporation are not diminished by the issue of the certificates, whereas the statute refers only to a "distribution made by a corporation to its shareholders . . . out of its earnings or profits." Neither does the exercise of the right to purchase constitute a dividend.

The majority of the Circuit Court of Appeals say that the statute "says nothing about intention"; that is true, but it does not follow that intention is immaterial. Whether a given transaction constitutes a distribution or sale depends upon the intention of the parties, just as it is the intention of the parties which determines whether a voluntary payment to an employee shall be deemed a gift or additional compensation. The statute, moreover, does not purport to tax the receipt of benefits by a stockholder, but only distributions "made in money or in other property." In a case like the present there is admittedly no distribution of money. Neither is there any distribution made in property. Since the stockholder pays for the property in question a large part of its value, if not the whole, it cannot be said that the *property* is distributed. An arrangement intended to be a sale and nothing else and enabling the stockholder merely to make a paper profit which may prove wholly illusory and which must, in any case, remain

unrealized unless and until the property is disposed of cannot be called a "distribution" within any ordinary meaning of that word. Whatever the true description of the transaction may be, it is certain that nothing is "distributed," for the simple reason that there is nothing which can be said to form the subject of any "distribution." To stretch this word as the Circuit Court of Appeals has attempted to stretch it reverses the well-settled rule as to the construction of tax statutes.

Gould v. *Gould*, 245 U.S. 151.
United States v. *Merriam*, 263 U.S. 179.
Old Colony R. Co. v. *Commissioner*, 284 U.S. 552.

The pertinence of this principle to the present situation is illustrated by cases in which it was applied to the construction of the analogous term "distributive share" as used in earlier revenue acts.

Page v. *Rives*, 1 Hughes, 297.
Disston v. *McLean* (C.C.A. 3), 147 Fed. 114.
Lynch v. *Union Trust Co.* (C.C.A. 9), 164 Fed. 161.

(*b*) If the amount paid by the taxpayer for the stock was no more than its fair value, there can, of course, be no tax on any theory. The Board of Tax Appeals found upon all the evidence that the amount paid for the stock to which the first issue of certificates related was no more than its fair value, and further found that the evidence did not establish the fair market value of the stock to which the second and third issues related (R. 164). The evidence upon which these findings were based was voluminous. While in the form of a stipulation, it presented a vast mass of detail, and any conclusion as to the value of the stock

was necessarily an inference from all these particulars (R. 64-155). Whatever may be said as to the significance of this or that element, it could not justly be said that the inferences which the Board drew were not such as reasonable men might arrive at upon the evidence taken as a whole. The Circuit Court of Appeals, though purporting to state the issue more narrowly, in substance treated the petition for review as if it had been an appeal in equity and assumed to draw inferences different from those drawn by the Board. As held by this court in the very recent case of *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U.S. 37, the Circuit Court of Appeals ought to have accepted the findings of the Board, even though these findings were in the nature of inferences from facts stipulated.

2. If it be assumed for the sake of argument that there was a dividend to the extent of any excess in the fair value of the stock over the amount paid by the stockholder and that the Circuit Court of Appeals was justified in finding that there was such an excess in fact, the amount of this excess is to be ascertained as of the dates when the taxpayer bought the stock, and not as of the dates when he received the purchase certificates. As has been pointed out above, it is only a "distribution" which the statute taxes. The essence of a distribution is a depletion of the corporation's assets (*Miles* v. *Safe Deposit & Trust Co.,* 259 U.S. 247). There is no depletion of assets on any possible view up to the time when the holder of a purchase certificate exercises the privilege of purchase and so acquires the stock theretofore owned by the corporation. In this respect the decision of the Circuit Court of Appeals for the First Circuit in the case at bar is right and that of the Circuit Court of Appeals for the Second Circuit in *Ramapo, Inc.,* v. *Commissioner,* 84 F. (2d) 986, manifestly wrong.

Argument.

I.

The Transactions gave Rise to no Taxable Income.

1. The Transactions Constituted Sales, and not Dividends.

If the price paid by the petitioner was no more than the fair market value of the stock, there can be no tax liability on any theory. Even if it were conclusively established, however, that the price was less than the fair market value, it would not follow that the transactions were taxable.

It may be assumed for the sake of argument that a transaction which is in form a sale by a corporation to its stockholders may under some circumstances constitute a dividend. This, however, is true only when the transaction is in substance a dividend and is given the form of a sale merely to disguise its true nature. The general rule is that a sale by a corporation to its stockholders, even if the price is much less than the fair value of the property, is not taxable as a dividend.

> *Taplin* v. *Commissioner* (C.C.A. 6) 41 F. (2d) 454.
>
> *Commissioner* v. *Van Vorst* (C.C.A. 9) 59 F. (2d) 677.

In the case last cited the court said (at p. 680):—

> "It is earnestly contended that the transaction denominated a sale was in fact a 'dividend' within the meaning of §201 (a) [of the Revenue Act of 1924, corresponding to §115 (a) of the Revenue Act of 1928] in that it was in effect a distribution made by the corporation to one of its shareholders in property out of its accumulated earnings. . . . If this contention is to be sustained, it must be based upon the proposition

urged that, because the consideration was so inadequate and the purchaser was the principal stockholder, it should for these reasons alone be regarded as a taxable distribution.

* * * * * * * * * *

"The contention that a transaction which is in form a sale may, nevertheless, constitute a distribution to a stockholder of corporate assets or earnings may be conceded. It does not follow, however, that every such sale should be regarded as a distribution. . . . In the absence of other showing, the mere fact that the purchaser is a stockholder of the vending corporation does not change the character of the transaction."

Whether a given transaction constitutes a sale or a dividend is a question of fact largely dependent upon intention and to be determined according to the evidence in the particular case, just as it is a question of fact whether, for example, a bonus received by an employee is a gift or additional compensation. Many decisions to this effect were cited by the taxpayer in the Circuit Court of Appeals.

Salvage v. *Commissioner* (C.C.A. 2) 76 F. (2d) 112; affirmed 297 U.S. 106.

Bass v. *Hawley* (C.C.A. 5) 62 F. (2d) 721.

Fisher v. *Commissioner* (C.C.A. 2) 59 F. (2d) 192.

Durkee v. *Welch* (D.C. S.D. Cal.) 49 F. (2d) 339.

Becker Brothers v. *United States* (C.C.A. 2) 7 F. (2d) 3.

United States v. *Philadelphia Knitting Mills Co.* (C.C.A. 3) 273 Fed. 657.

Schumacher v. *United States*, 74 Ct. Cl. 720.

The following extract from the opinion in the case last cited illustrates the controlling significance of intention in situations of this kind (italics supplied):—

> "The plaintiff suggests the use of the words 'compensate employees' and 'additional compensation,' in the secretary's letter, 'merely emphasizes that inartistic and unintentionally misleading language was employed to describe what was *intended* to be, and what actually were, gifts.' We do not agree with plaintiff that these expressions are inartistic, or that they are misleading. The words 'compensate employees,' 'additional compensation,' and 'bonus' have a precise and well-understood meaning, and in the absence of any fact or circumstances showing they were not used in their ordinary sense they must be accorded their usual signification. *It is significant of the intention of the parties that the word 'gift' nowhere appears in the entire transaction. When the payments are referred to, they are invariably designated as 'additional compensation,' 'compensate employees,' or 'bonus' indicating beyond question that the payments were not gifts or gratuities.*
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> "We hold, therefore, that the payment of $100,000 to the plaintiff on January 2, 1925, by the stockholders' committee was *intended* to be, and was, additional compensation for services rendered."

The importance of intention in situations analogous to that now disclosed is emphasized by the series of decisions recently rendered by different Circuit Courts of Appeals respecting certain voluntary payments to employees of the Universal Oil Products Company. In each of these cases it has been held that, for the purpose of determining whether

the payments in question should be deemed gifts or additional compensation, the intent with which the payments were made was decisive and that the court could not go behind a finding by the Board of Tax Appeals to the effect that they were intended to constitute compensation.

Hall v. *Commissioner* (C.C.A. 4) 89 F. (2d) 441.
Simpkinson v. *Commissioner* (C.C.A. 5) 89 F. (2d) 397.
Bogardus v. *Helvering* (C.C.A. 2) 88 F. (2d) 646.
Walker v. *Commissioner* (C.C.A. 1) 88 F. (2d) 61.

It is noteworthy that the case last cited was decided by the Circuit Court of Appeals for the First Circuit on the same day as the case at bar. Apparently not appreciating the inconsistency of the two decisions, the court in *Walker* v. *Commissioner* (at p. 62) quoted with approval the following language from *Fisher* v. *Commissioner,* 59 F. (2d) 192 (at p. 193):—

> "Whether a payment in a given case shall be deemed taxable compensation or a gift exempt from tax depends upon the intention of the parties, and particularly that of the employer, to be determined from the facts and circumstances surrounding the transaction."

In the present instance the Board of Tax Appeals has found,—and the propriety of the finding has not been questioned,—that there was no intention to distribute to the stockholders of The American Superpower Corporation any of its earnings or assets, but that *the purpose was to build up its cash position and to create a wide market for the stock of The United Corporation* (R. 160, 163-164). The price at which the first lot of The United Corporation stock was offered to the stockholders of The American Super-

power Corporation represented, as noted above, the precise amount fixed by the Commissioner as the fair market value of that stock. The price paid by the stockholders was likewise the exact price paid by The American Superpower Corporation for the stock of The United Corporation and of The Commonwealth & Southern Corporation measured by the value of the securities given in exchange (R. 84-86). As pointed out above, the sale of this stock to the stockholders of The American Superpower Corporation was a part of the plan pursuant to which it was acquired.

It is thus apparent that, as the Board said, "no valid argument can be made that Superpower intended to distribute to its stockholders any portion of its assets by selling 821,472 common shares of United to them at a fair market value" (R. 164). Upon each of the three sales, moreover, The American Superpower Corporation realized a large profit with reference to the cost of the securities given by it in exchange for those sold (R. 162). So far as appears, the course pursued was an eminently judicious means of attaining the objects which the officers of The American Superpower Corporation had in view; there is nothing to suggest that it would have been more prudent to throw these large blocks of stock on the market and to take the chances as to sums realized.

The majority of the Circuit Court of Appeals in the case at bar said, as noted above (R. 191):—

> "The question is not one of intention, but of what was in fact done. The statute defines dividend. . . . It says nothing about intention. The transaction is to be judged by the effect of it."

It is apparent that this assertion was wrong unless it can be said that under the particular circumstances disclosed in the present case the intention of the parties was immaterial and that, notwithstanding their intention, the

transactions constituted dividends as matter of law. As shown by the cases cited above, this cannot be said merely because the price may have been less than the actual value of the stock, The precise question is whether a transaction fully intended to be a sale and nothing else nevertheless constitutes a dividend as matter of law if there is present the additional fact that the property sold was offered to all the stockholders *pro rata*. The majority of the Circuit Court of Appeals for the First Circuit answer this question in the affirmative. The Circuit Court of Appeals for the Second Circuit,—in *Ramapo, Inc.,* v. *Commissioner,* 84 F. (2d) 986,—and the Circuit Court of Appeals for the Seventh Circuit,—in *Commissioner* v. *Mayer,* 86 F. (2d) 593,—have held that sales like those now in question constitute dividends, though neither court has ruled except by implication that the intention of the parties is immaterial. The dissenting judge in the present case, the Circuit Court of Appeals for the Fourth Circuit,—in *Helvering* v. *Bartlett,* 71 F. (2d) 598,—and the Circuit Court of Appeals for the Fifth Circuit,—in *Commissioner* v. *Cummings,* 77 F. (2d) 670,—answer the question in the negative.

There is little in the opinion in *Ramapo, Inc.,* v. *Commissioner,* 84 F. (2d) 986, that helps the Commissioner in the case at bar. While that case related, indeed, to the same issues of purchase certificates by The American Superpower Corporation as are involved in the present case, the circumstances of the parties were very different. In the *Ramapo* case the taxpayer was a corporation and it asserted that the options which it received were dividends, the value of which was to be deducted from its gross income in determining its taxable income. The Commissioner also treated the value of the rights as dividends, but determined their value as of a different date from that taken by the taxpayer. By amended answer the Commissioner later moved to increase the deficiency determined by him if he

had made any errors in favor of the taxpayer. The Board of Tax Appeals held that the rights were not dividend distributions at all, but merely represented options, and that the entire amount which the petitioner had received from the sale of rights constituted taxable income.

The opinion of the Circuit Court of Appeals in the *Ramapo* case does not deal with the facts appearing in the present record with regard to the circumstances under which the options were issued and the purpose of issuing them. Doubtless because these matters were not brought out, the court disposed of the case with the mere statement that, when a corporation issues rights to purchase stock in another corporation at less than its fair market value, "the issuance of them is a distribution of corporate assets in the amount by which the value of the stock exceeds the price to be paid for it, and, if such excess represents earnings or surplus, is a dividend." It is apparent from this statement that the court did not analyze the situation with care. Even if the statement were not altogether too sweeping in eliminating entirely from consideration the purpose of the transaction and the question whether a sale was in good faith intended rather than a distribution, the court was obviously in error, since the mere *issue* of rights could in no event constitute a distribution of assets. If the rights are not exercised, the corporate assets remain unaffected. Those assets are not diminished unless and until their rights are exercised and the property acquired from the corporation.

The citation of authorities manifests the same lack of analysis. In *Metcalf's Estate* v. *Commissioner,* 32 F. (2d) 192,—a decision of the same Circuit Court of Appeals,—the taxpayer had sold the rights and the question, as the court said, was "whether, by the selling of these rights, the petitioner received taxable income." In *Duke* v. *Commissioner,* 18 B.T.A. 374, and *Bradley* v. *Commissioner,* 1

B.T.A. 111, it was found as a fact that the purpose was to effect a distribution of the company's property among its stockholders whereas in the case at bar the finding is just the reverse. In *Venner* v. *Southern Pacific Co.* (C.C.A. 2) 279 Fed. 832, similarly, it appeared that the whole purpose of the transaction was to distribute among the stockholders property which it had become unlawful for the company itself to hold; the controversy, moreover, was not as to whether the distribution gave rise to tax liability, but whether the particular manner in which it was effected violated the rights of the stockholders.

The opinion in *Commissioner* v. *Mayer,* 86 F. (2d) 593, contains even less discussion of the controlling principles than does the opinion in *Ramapo, Inc.,* v. *Commissioner.* After stating what is undisputed, *i.e.,* "that a dividend of stock of another company may be the subject of an income tax," the court say dogmatically: "Also it is settled that the grant of a right to purchase stock is essentially analogous to a dividend of stock." The decision in the *Ramapo* case is the sole authority cited for this proposition.

The sound view of a situation like the present is, the taxpayer submits, that taken by the Circuit Court of Appeals for the Fourth Circuit in *Helvering* v. *Bartlett,* 71 F. (2d) 598, in which the court said (at p. 600):—

> "It seems clear that one is not to be taxed as upon income merely because he acquires an option which he might sell for value. If he allows the option to expire without exercising it, he has, of course, received no income. If he sells his rights under the option, he is taxable on the amount received on the sale. If he exercises it by making a purchase, his income from the transaction is determined on the basis of the profit realized when he sells the property purchased.
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"In *Miles* v. *Safe Deposit & Trust Co.*, 259 U.S. 247, it was held that, where a stockholder sold rights to subscribe to new stock in a corporation, the amount thus realized was taxable as income; but the court pointed out that, if he had decided to accept the new shares instead of selling the rights, there would have been no profit and hence no taxable income. It is true that in that case, it was the stock of the same corporation which was referred to; but the same principle would hold as to the purchase of stock of another corporation. No profit is realized upon a purchase; and the mere according of a right to purchase is not to be treated as a dividend or distribution of assets, unless these are in fact involved and the right to purchase is a mere cloak for a transaction which is essentially something else.

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"Even a purchase at a bargain does not result in taxable income, unless used as a cloak for what is in fact a dividend. *Commissioner* v. *Van Vorst*, 59 F. (2d) 677.

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"As has been often said, taxation is a practical matter. The income tax law is concerned, generally speaking, only with realized gains or losses. *Lucas* v. *American Code Co.*, 280 U. S. 445, 449; *Burnet* v. *Logan*, 283 U. S. 404, 413. And no gain has been realized by this taxpayer as a result of the allotment to him of the rights in question or of his purchase under those rights. That he might have realized a profit if he had sold the rights is beside the point. Taxes must be imposed on the basis of what has happened, not on the basis of what might have happened. It is important to note that the exact case here presented is covered by G. C. M.

7246, C. B. 1929, p. 80; and the administrative practice thus prescribed is entitled to great weight in determining the applicability of the statute which the government invokes. *Logan* v. *Davis,* 233 U. S. 613, 627."

At the hearing in the Circuit Court of Appeals it was suggested by the Commissioner that *Helvering* v. *Bartlett* was distinguishable on its facts. Brief analysis, however, is sufficient to show that that case is substantially identical with the case at bar, especially with reference to the options issued by The American Superpower Corporation in January and June. In each of those instances the options were issued in connection with the original organization of the corporation whose shares were covered by the options. The only difference in point of fact is that in the *Bartlett* case, after the original corporation had voted to purchase 50,000 shares of the new company, it offered half of these shares to its shareholders at the same price and they were sold directly to the shareholders without the completion of the purchase by the original company. The original corporation had the right to buy the shares offered to its shareholders, would have had to take them up if they had not and could have retained for itself, if it had so chosen, the excess value over the purchase price. It gave up this right to its shareholders; and the fact that the transaction did not go through its books furnishes no ground for distinguishing the case from the case at bar. This was in effect recognized in the *Ramapo* case; the court made no attempt to distinguish the *Bartlett* case, but merely remarked that, "if *Helvering* v. *Bartlett* be deemed to hold the contrary, we cannot follow it."

Commissioner v. *Cummings,* 77 F. (2d) 670, is to the same effect. While the immediate issue was not that now presented, the determining principle was exactly the same. In the following quotation from the opinion of the court

(77 F. [2d] at p. 672) the more important passages are italicized:—

"[The stipulated facts] show merely the issuance and purchase of stock options on Southeastern stock, and the exercise of these options by the purchase of the stock. . . . Taxation does not concern itself with hypotheses, but with real situations. *Helvering* v. *Bartlett* (C.C.A.) 71 F. (2d) 598. *The real situation here is that detachable stock rights, purchased and owned detached from the ownership of stock, and having a value of around $50 a right, were exercised. Had these warrants been sold, the gains would have been taxable as income. Metcalf's Estate* v. *Com'r* (C.C.A.) 32 F. (2d) 192; *Helvering* v. *Bartlett, supra. They were not sold; they were exercised in the purchase of the stock. They were nothing but options to purchase stock. Neither their purchase nor their exercise resulted in taxable gain.* They came into existence as property when they were purchased; they disappeared as property when, instead of being sold or exchanged as property, they were by their exercise merged into the executed contract represented by the stock they gave the right to buy. *Helvering* v. *Comm'r, supra.* The shares thus acquired came to the taxpayer as new property. *Wood* v. *Comm'r* (C. C. A.) 75 F. (2d) 364. They may not be considered as standing for the options upon the exercise of which they were purchased, and therefore as held for more than two years prior to their exchange and sale. *The result of the facts stipulated is that whatever the taxpayer might have done, what he did do was to exercise his rights to buy stock; that the exercise of this option gave rise to no taxable gain.* It merely put him in the position of acquiring shares of stock as new capital, as to which, when he sold them, he had to

account for the profits on the basis of their cost, which was the cost of the warrants, plus $30,050 cash paid when the stock was acquired."

It has already been shown that, as was recognized by the court below in the present case, the mere receipt of purchase certificates by a stockholder cannot on any theory constitute a dividend. The subject of the tax, if any, is the difference between the fair value of the stock and the amount paid for it upon the exercise of the right to purchase. In the *Cummings* case it was expressly held that this difference was not taxable. The decision is, therefore, a direct authority in favor of the view expressed by the Board of Tax Appeals and by the minority of the Circuit Court of Appeals in the case at bar.

This view is further confirmed by considering the converse of the situation now in question, *i.e.*, a case in which cash is paid to a stockholder who has conveyed property to the corporation. The classification of such a payment for income tax purposes depends upon the intent with which it was made; it will not be deemed a "distribution" if intended to constitute payment for the property conveyed, even though it is described in the corporate records as a dividend. In *Curran* v. *Commissioner* (C.C.A. 8) 49 F. (2d) 129, the court said (at p. 131):—

> "Under the evidence (fairly represented by the findings) the Board might have concluded either that there was a gift to the corporation and a real dividend or that there was a sale and a purchase payment which took the form of a dividend. Either view would have been substantially supported by the evidence and, therefore, not disturbed here. The Board found there was a sale. It finds that 'it was finally agreed that the corporation would pay and he would take $150,000.00

for the property. The petitioner then executed and delivered the deed to the property which was recorded October 13, 1920. No payment was made to the petitioner on account of the transfer of the property in 1920.' The findings following the quotation just made leave no doubt of the view of the Board that this 'dividend' for $150,000 declared January 15, 1921, was really in payment of this purchase price. In this connection there is a significant statement in the opinion of the Board on the findings as follows: 'We are convinced from all the evidence that the petitioner intended that the corporation should pay $150,000 for the property. We also believe that the petitioner was satisfied with the action as taken by the corporation in declaring and paying the dividend.' We think the findings must be construed as being that the property was sold to the corporation, and that payment therefor was through the medium of this 'dividend.' "

The Board of Tax Appeals, moreover, has consistently acted on the principle applied in *Helvering* v. *Bartlett* and *Commissioner* v. *Cummings*.

Van Vorst v. *Commissioner*, 22 B.T.A. 632.
Everhart v. *Commissioner*, 26 B.T.A. 318.
Powel v. *Commissioner*, 27 B.T.A. 55.
W. M. Ritter Lumber Co. v. *Commissioner*, 30 B.T.A. 231, 274.
Freshman v. *Commissioner*, 33 B.T.A. 394, 403-404.

That principle, the taxpayer submits, governs the case at bar.

2. The Finding of the Board of Tax Appeals as to the Value of the Stock in Question was conclusive.

Unless the fair market value of the stock when bought by the petitioner exceeded the prices paid by him, the transaction could not give rise to tax liability on any theory. The evidence before the Board of Tax Appeals consisted of a stipulation setting out a great variety of facts bearing on the question of value (R. 68-161). The Board was unable to find that there was in fact any excess of value and, indeed, made with respect to the first set of purchase certificates an affirmative finding that the value did not exceed the amount paid by the petitioner, *i.e.*, $25 per share (R. 170-171). Although the findings of the Board were in the nature of inferences drawn from the facts stipulated, these findings were no less binding on the Circuit Court of Appeals than they would have been if based on oral testimony.

Helvering v. *Rankin,* 295 U.S. 123.
General Utilities Co. v. *Helvering,* 296 U.S. 200.
Elmhurst Cemetery Co. v. *Commissioner,* 300 U.S. 37.
Johnson v. *Commissioner* (C.C.A. 8) 88 F. (2d) 952.

In the case last cited the court quoted with approval the following passage from the opinion in *Randolph* v. *Commissioner* (C.C.A. 8) 76 F. (2d) 472, 476:—

> "Even though the evidence before the Board is undisputed, the finding of the Board will not be disturbed by this court if different inferences may reasonably be drawn from such evidence."

It is true that the Circuit Court of Appeals was not concluded by the findings of the Board if these were wrong as matter of law. It is not, however, suggested that this

was the case; on the contrary, it appears that the Commissioner, in determining the tax liability of The American Superpower Corporation for 1929, fixed the fair market value of the shares of The United Corporation held by it in January, 1929, at $25 per share (R. 89, 167). It was proper, of course, to consider daily quotations of the rights on the Curb, but these quotations were to be weighed with all the other evidence and were of themselves indecisive, especially when the abnormal conditions which existed in 1929 are considered.

San Francisco National Bank v. *Dodge,* 197 U.S. 70.
Strong v. *Rogers* (C.C.A. 3) 72 F. (2d) 455.
Heiner v. *Crosby* (C.C.A. 3) 24 F. (2d) 191.

The majority of the Circuit Court of Appeals in this respect fell into the same error as that corrected by this court in *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U.S. 37, and assumed to make findings *de novo* substantially as upon an appeal in equity. Had the majority given proper weight to the findings of the Board, the result would have been in favor of the taxpayer regardless of whether there would have been a "dividend," if the price paid by him had been less than the fair value of the stock purchased. It follows that the judgment of the Circuit Court of Appeals must be reversed, apart from the question discussed in the previous section of this brief.

II.

If the Transactions constituted Dividends at all, the Value of the Stock is to be ascertained as of the Dates when it was actually purchased.

As noted above, the Circuit Court of Appeals for the Second Circuit in *Ramapo, Inc.,* v. *Commissioner,* 84 F.

(2d) 986, took the view that in a situation like the present each issue of purchase certificates constitutes the payment of a dividend and that the amount of this dividend is the sum for which the certificates could be sold in the market on the date of issue. In the case at bar it was held that the exercise of the right to purchase constituted the receipt of a dividend, so that the amount taxable was the difference between the sum paid and the market value of the stock at the date on which the option was exercised. The Commissioner asks that this ruling be reviewed, but it is apprehended that this is with a view to resolving the conflict between the two decisions rather than with any expectation that the position taken in the *Ramapo* case will be sustained.

The fundamental error in that view is the failure to consider the words of the statute:—"The term 'dividend' when used in this title . . . means any distribution made by a corporation to its shareholders." The mere granting of an option to buy from the corporation, even though readily salable, manifestly is not a "distribution," since it in no way reduces the corporation's assets.

Miles v. *Safe Deposit & Trust Co.*, 259 U.S. 247.

If a stockholder sells the option, he may be taxable for a gain, but not for a dividend, since nothing has been distributed to him. The only step which could on any theory be deemed a "distribution" is the transfer of stock to the holder of the option at a price less than the fair value. The principle is analogous to that upon which this court acted, in *Helvering* v. *San Joaquin Fruit & Investment Co.*, 297 U.S. 496; as was held in that case, one exercising an option to purchase land must be taken to "acquire" the land within the meaning of the Revenue Acts, not at the date of the option, but at the date of the conveyance. The principle is likewise similar to that whereby the cost basis of

property received by a remainderman under a trust is taken as the value at the date of actual distribution, not the value at the time of the life tenant's death.

Lane v. *Corwin* (C.C.A. 2) 63 F. (2d) 767.
Becker v. *Anchor Realty & Investment Co.* (C.C.A. 8) 71 F. (2d) 355.
Haskell v. *Commissioner* (C.C.A. 3) 78 F. (2d) 869.
Van Nostrand v. *United States* (D.C. Mass.) 18 F. Supp. 295.

It follows that the judgment of the Circuit Court of Appeals, in so far as it held that the mere issue of the purchase certificates did not constitute a "dividend," was right. Upon the taxpayer's view of the case, however, there was no dividend at any stage of the transaction, so that the point of difference between the respective Circuit Courts of Appeals is immaterial.

The taxpayer accordingly submits that upon the whole record the judgment of the Circuit Court of Appeals should be reversed and the decision of the Board of Tax Appeals affirmed.

Respectfully submitted,

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